

OUTLOOK 2011: Paints Buyers Caught in a Tight Squeeze

As the global economy moves into the coming year, optimism is slowly growing. A number of metrics are pointing to improving business and consumer sentiment but the construction industry—a major end user of paints and coatings—is still lagging the recovery seen in other industries. And paints raw materials costs are on the rise. This will set the stage for ongoing pricing pressure for paints in the coming year.

According to a recent poll by the Business Roundtable, company executives are now the most optimistic in the past five years. The executives surveyed are forecasting higher sales, increased capital spending on new equipment and construction, and growing payrolls. A loosening of business spending will further improve consumer sentiment.

That's a good thing. Despite the depressed job market and the ongoing mortgage crisis, consumers appear to be rebounding. Fourth-quarter spending is estimated to have grown by 4 to 4.5% — the strongest rate in four years.

All of this is critical to bolster spending and get all sectors of the economy working again. The construction sector was one of the hardest hit during the downturn. It's been slow to come back.

Now, analysts say that the industry hit bottom in 2010 and will begin to recover this year. According to the Associated General Contractors of America, non-residential construction should rise by 5% this year. The outlook for residential construction isn't quite so rosy, but even with an oversupplied market and high foreclosure numbers, the American Chemistry Council expects housing starts to increase over the anemic 2010 levels.

These numbers offer some glimmers of hope for the paints industry and its customers. Unfortunately, they may not be enough. There are other numbers that come into play: rising costs. Across the board, the cost of paints raw materials, freight and packaging continue to climb. Diesel prices climbed 28% last year. Other construction raw materials, like copper, steel and aluminum, rose by about 12% in 2010. Now, some paint feedstocks are experiencing double-digit increases in January, which doesn't bode well for the coming year. This comes at a time when weak demand for construction and fierce competition for work is keeping a lid on the prices that contractors can charge for new building projects. Increased costs will only add to the squeeze. ■

UPDATE: Latex Raw Materials

There's little good news to report so far this year when it comes to the raw materials used in latex paints.

A string of plant incidents beginning in late 2009 kept the supply of acrylic monomers tight throughout 2010. It seemed that no sooner was one downed plant back up and running than another one would announce a problem. By mid-year, it amounted to a supply shortage. Raw materials buyers were scrambling to source enough material to keep paint production lines running and were paying high prices to do so.

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FOCUS: TiO₂

TiO₂ Prices Still Rising

The supply and cost of titanium dioxide (TiO₂) will continue to challenge the paints and coatings industry in 2011. The white pigment is used in a vast range of products, everything from paints to plastics, paper and inks, cosmetics and even foods. Demand is rising and, with over 10% of global capacity taken offline in the past three years, supply is tight. Analysts say it will take several years before capacity catches up with supply. In the meantime, prices are going up.

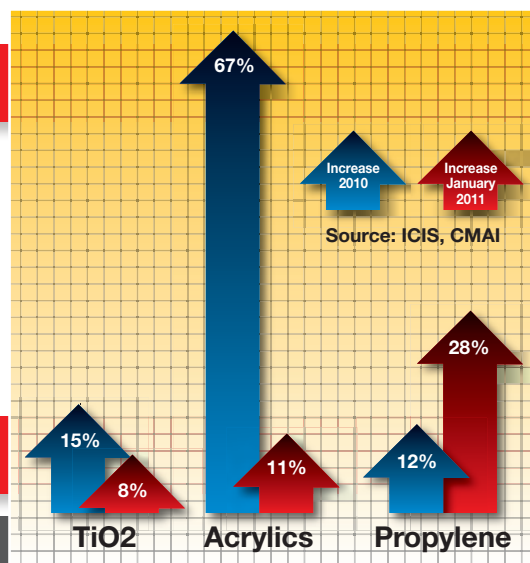
Lean operating procedures and cost-cutting initiatives reduced TiO₂ inventories to bare-bones levels during the recession. This has made the supply chain especially vulnerable to unexpected outages, which not only reduce the material available to the market but also give suppliers an excuse to raise prices.

That's exactly what happened in late September when a major North American TiO₂ producer's plant shut down unexpectedly. The company declared force majeure on

production from the plant, meaning that an "act of God" had rendered them incapable of honoring their contracts. This tightened supply and led other producers to raise prices. The plant was back online by the end of November but the company put tight controls on the amount of pigment it was sending to the market.

Adding to the pain this year, the cost of the raw materials, including sulfuric acid, used to manufacture TiO₂ is rising. Add higher energy prices to the mix—TiO₂ production is a complex, energy-intensive process—and pigments are being hit from all sides.

As a result, TiO₂ prices climbed 15% in 2010 and producers announced additional increases of up to 8% for January. Now, many companies say that they could sell much more material than they can currently produce. Analysts expect the market to remain tight and for prices to rise an additional 6 to 8% per quarter through the end of the year. ■



HIDDEN COSTS: **Related Products**

Paints aren't the only products being affected by rising raw materials costs; expect the price of just about every item that a contractor needs to do a job to increase this year. The rising price of oil is behind much of the inflation. But other factors, like higher commodity prices and weather-related issues are also taking a toll.

Crude oil is the starting point for many of the plastics used in everything from the fibers that make up paint brushes to polyester roller covers, trays, buckets, pail and tray liners, and even the contractors plastic spread underfoot to catch spills. The cost of crude today is about 50% higher than the average price paid in 2009. In the first month of the year, it's already 15% higher than the average price for 2010.

Those kinds of increases won't go unnoticed. The rise is translating into steep increases for plastics, including polyester, polypropylene, polyethylene and PET. Prices are up anywhere from 30 to 60% over 2009 and are already up 15 to 20% over 2010. These increases will eventually be felt on the shelves of your local paint supply store.

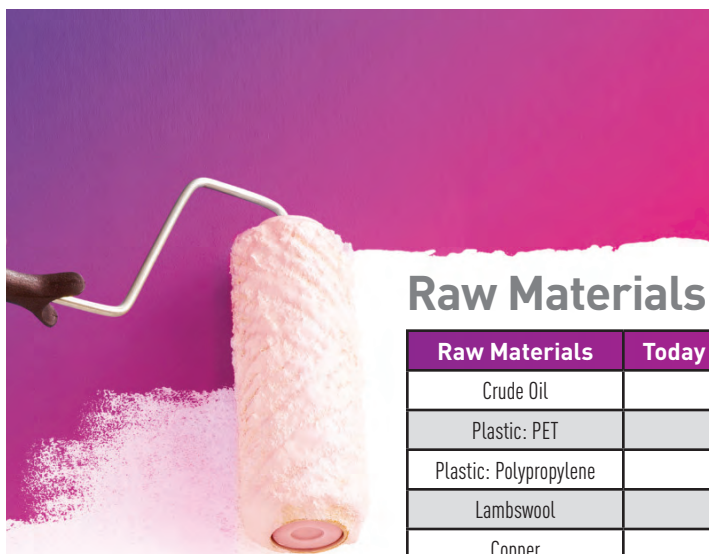
One plastic pail might be much like the next but premium tools often cost a little bit more. They're not immune from the cost

escalation. Lambswool roller covers are a good example. Today, the price of wool is over 20% higher than the average for 2010. In fact, wool prices are at the highest levels seen in the past 20 years. Weather problems in Australia, the world's largest wool exporter, have reduced supply in recent years. Plus, wool is experiencing a bit of a renaissance in clothing lines, especially for active sports-wear. And with cotton prices climbing, clothiers and textile makers are turning to wool as an alternative, further boosting demand.

Another good example is the thin sheet of copper wrapped around the bristles on premium horsehair and boar's hair brushes. Copper prices have climbed 20% already this year and analysts expect them to continue the upward trend. Tightening supply and strong demand from financial markets and consumers are inflating prices.

Skyrocketing cotton prices—they broke a post-Civil War record in December—are going to influence the cost of canvas drop clothes, painters' rags, coveralls and other clothing. The demand for cotton from China, the world's largest consumer of the fiber, is insatiable but global supply has also tightened. U.S. stockpiles dropped considerably this year and hail in Texas damaged crops, lowered yields and constrained supply. The situation wasn't much better elsewhere. The harvest was late in India and the country imposed export controls on cotton. Meanwhile, floods reduced harvests in Pakistan and China.

The bad news doesn't stop with tools and coveralls, either. Gasoline and diesel prices are on the rise, so filling up the truck will cost more and transportation fees for paint and related products will add to the price tags. Solvent prices are rising in tandem with gasoline prices. The cost of shellac is up. Even lunch is going to take a bigger bite this year than last. All of this means that higher prices are on tap for 2011. ■



Raw Materials Price Increases

Raw Materials	Today vs. avg 2009	Today vs. avg 2010	Uses
Crude Oil	50%	15%	Transport, feedstock for plastics & solvents
Plastic: PET	30%	15%	Roller covers, paint brushes, clothing
Plastic: Polypropylene	60%	20%	Pails, buckets, liners
Lambswool	63%	23%	Roller covers
Copper	77%	21%	Paint brushes
Cotton	168%	62%	Drop clothes, rags, clothing

UPDATE: **Latex Raw Materials** Continued

The supply issues eased somewhat during the second half of the year. However, demand remains strong in 2011, especially for acrylic acid, the precursor to the acrylic monomers used in paints. Other markets are competing for the limited supply. Demand is especially strong from superabsorbent polymers, which soak up moisture in diapers and incontinence products. Because of the demand, suppliers have been unable to build inventories, which means that any disruption to the supply chain can quickly lead to new shortages in the market.

The price of acrylic monomers has continued the upward trend seen in 2010. Acrylic acid prices, which rose 67% in 2010

and another 11% in January, set the bar for prices for paints raw materials like butyl acrylate and methyl methacrylate (MMA).

This year, rising feedstock prices are adding pressure. The price of upstream propylene jumped 28% in January after increasing 12% in 2010. Meanwhile, new acrylic acid supply issues are emerging in Europe and could threaten global markets. So far supply has held steady in North America, but this could change at any time. Suppliers are responding by moving prices higher. Acrylic monomer producers announced price increases of 5 to 12% for January. Now, they're coming back to the market with similar increases for February. ■